London Borough of Merton Pension Fund

Q2 2021 Investment Monitoring Report

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HYMANS ROBERTSON

Executive Summary

The Fund's assets returned 4.8% over Q2 2021. To provide context, we have assessed total returns against a composite benchmark - a weighted average of the underlying manager benchmarks. Against this comparator, the Fund was comfortably ahead (top left chart). We have also shown performance against the Fund's actuarial target (top right chart).

Owing to the positive performance, assets grew from £898.8m to £926.1m.

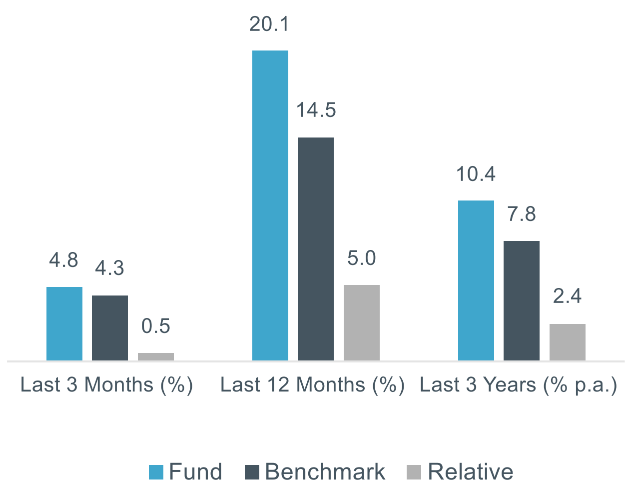
In markets, global equities rose 7.3% during the second quarter, buoyed by positive signs of the vaccine rollout. Inflation expectations remained a concern, with year on year inflation spiking during the quarter. Property markets enjoyed an easing of lockdown restrictions with valuations continuing to improve, perhaps with the exception of retail.

Within fixed income markets, nominal gilts yields pushed lower whilst a narrowing of credit spreads reflected an improvement in overall market sentiment.

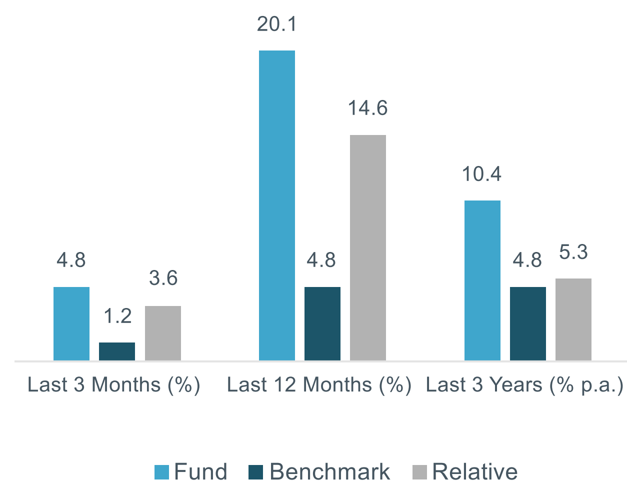
From a fund mandate perspective:

- The equity mandates delivered positive absolute returns as markets continued to recover.
- The LCIV Diversified Growth Fund delivered strong positive relative returns.
- The Property funds contributed positively in absolute terms to overall Fund performance.
- The Risk Management Framework contributed positively to returns due to yields moving lower.

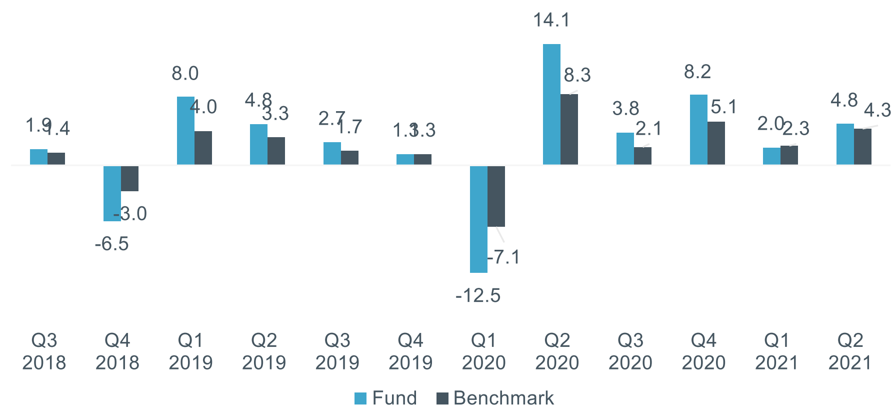
Fund performance vs benchmark/target



Fund performance vs actuarial target



Relative quarterly performance vs benchmark/target



Following the 2019 strategy review the agreed long-term target allocation for the Fund is as follows:

Global equities: 30%
Emerging market equities: 10%
Diversified growth fund: 8%
Property: 5%
Private credit: 6.5%
Infrastructure: 11.5%
Social Impact: 5%
Multi-asset credit: 9%
Risk management framework: 15%

In time the Fund will transition towards this target allocation. As it does, the benchmark (as agreed with Officers) shown in the table and used in the benchmark performance calculation on the next will be gradually updated to reflect progress to date.

Commitments to infrastructure and private credit investments continued to be drawn down over time.

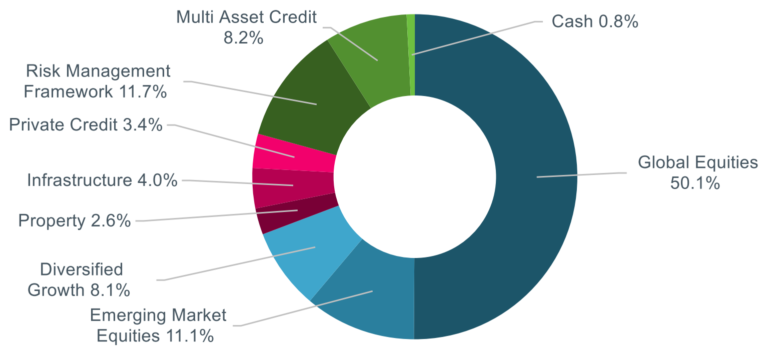
The Fund's allocation to social impact investment is still to be considered.

In the meantime, the Fund will continue to carry a larger growth allocation which in itself carries risk. Fund Officers and Panel members are in the process of considering options available to them to address this and potentially reduce the level of risk within the current allocation.

Asset Allocation

Mandate	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q1 21	Q2 21			
UBS World Equity Tracker Fund	54.1	36.5	3.9%	0.0%	3.9%
UBS Alternative Beta	88.0	95.2	10.3%	10.0%	0.3%
LCIV RBC Sustainable Equity Fund	104.4	113.7	12.3%	10.0%	2.3%
LCIV Baillie Gifford Global Alpha Growth Fund	109.6	117.4	12.7%	10.0%	2.7%
BlackRock World Low Carbon Equity Tracker	94.2	101.1	10.9%	10.0%	0.9%
Global Equities	**450.3**	**463.8**	**50.1%**	**40.0%**	**10.1%**
UBS GEM HALO	60.6	61.8	6.7%	5.0%	1.7%
LCIV JP Morgan Emerging Market Equity Fund	39.5	40.8	4.4%	5.0%	-0.6%
Emerging Market Equities	**100.1**	**102.6**	**11.1%**	**10.0%**	**1.1%**
LCIV Ruffer Absolute Return Fund	37.4	37.6	4.1%	5.0%	-0.9%
LCIV Baillie Gifford Diversified Growth Fund	35.4	37.1	4.0%	5.0%	-1.0%
Diversified Growth	**72.8**	**74.8**	**8.1%**	**10.0%**	**-1.9%**
UBS Triton Property Fund	16.8	16.6	1.8%	2.5%	-0.7%
BlackRock UK Property Fund	7.6	7.8	0.8%	2.5%	-1.7%
Property	**24.4**	**24.3**	**2.6%**	**5.0%**	**-2.4%**
MIRA Infrastructure Global Solutions II L.P Fund	7.6	8.2	0.9%	3.0%	-2.1%
Quinbrook Low Carbon Power LP Fund	11.8	11.7	1.3%	1.5%	-0.2%
JP Morgan Infrastructure Fund	18.0	17.0	1.8%	3.0%	-1.2%
Infrastructure	**37.5**	**36.9**	**4.0%**	**7.5%**	**-3.5%**
Permira Credit Solutions IV Fund	14.9	14.8	1.6%	4.5%	-2.9%
Churchill Middle Market Senior Loan II Fund	16.3	16.7	1.8%	3.0%	-1.2%
Private Credit	**31.3**	**31.5**	**3.4%**	**7.5%**	**-4.1%**
Wells Fargo RMF Fund	106.4	108.2	11.7%	10.0%	1.7%
Risk Management Framework	**106.4**	**108.2**	**11.7%**	**10.0%**	**1.7%**
LCIV CQS MAC Fund	74.8	76.3	8.2%	10.0%	-1.8%
Multi Asset Credit	**74.8**	**76.3**	**8.2%**	**10.0%**	**-1.8%**
Cash	1.2	7.5	0.8%	0.0%	0.8%
Total Fund	**898.8**	**926.1**	**100.0%**	**100.0%**	

Asset class exposures



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Source: Investment Managers

During Q2 2021, the Total Fund return was 4.8%, outperforming its benchmark with relative returns of 0.5%. Over the longer time periods of 12 months and 3 years, performance in relative terms was positive with the Fund recording 5.0% and 2.4% p.a. respectively.

The main drivers of performance were the Fund’s equity mandates during the quarter. In particular, the LCIV Sustainable Equity Fund returned 8.9% in absolute terms making it the highest performing equity mandate during the quarter. The worst performing global equity mandate was the BlackRock World Low Carbon Tracker despite still achieving a 7.3% absolute return.

Both of the emerging market funds struggled during the quarter with neither able to match its benchmark.

Ruffer’s defensive positioning and limited (c40% allocation) to equities saw the portfolio narrowly under performance its target.

Both property funds recorded positive absolute returns despite both failing to meet benchmark. Rental income streams remained robust whilst capital appreciation was prevalent – particularly in the logistics and warehouse sectors.

Following discussions with WFAM, as the mandate has no stated benchmark, we have chosen to benchmark against passive bonds and currency - reflecting the nature of its mandate.

Manager performance

Mandate	Last 3 Months (%)			Last 12 Months (%)			Last 3 Years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
UBS World Equity Tracker Fund	7.5	7.5	**0.0**	25.0	25.0	**-0.1**	-	-	-
UBS Alternative Beta	7.1	7.0	**0.1**	22.0	22.0	**0.0**	-	-	-
LCIV RBC Sustainable Equity Fund	8.9	7.6	**1.2**	29.6	24.4	**4.2**	17.0	13.3	**3.3**
LCIV Baillie Gifford Global Alpha Growth Fund	7.1	7.5	**-0.4**	30.9	25.5	**4.3**	18.8	13.4	**4.7**
BlackRock World Low Carbon Equity Tracker	7.3	7.8	**-0.5**	24.7	25.3	**-0.5**	-	-	-
Global Equities									
UBS GEM HALO	1.8	4.9	**-2.9**	22.9	25.9	**-2.4**	-	-	-
LCIV JP Morgan Emerging Market Equity Fund	3.2	4.9	**-1.6**	30.6	26.0	**3.7**	-	-	-
Emerging Market Equities									
LCIV Ruffer Absolute Return Fund	0.7	0.8	**-0.1**	5.5	1.4	**4.0**	-	-	-
LCIV Baillie Gifford Diversified Growth Fund	4.9	0.9	**4.0**	14.3	3.6	**10.3**	4.6	4.0	**0.5**
Diversified Growth									
UBS Triton Property Fund	3.5	3.8	**-0.3**	10.0	8.5	**1.3**	4.1	3.0	**1.0**
BlackRock UK Property Fund	2.8	3.8	**-1.0**	8.2	8.5	**-0.3**	2.9	3.0	**-0.2**
Property									
MIRA Infrastructure Global Solutions II L.P Fund	-0.7	1.8	**-2.5**	8.2	7.4	**0.7**	-	-	-
Quinbrook Low Carbon Power LP Fund	4.5	1.8	**2.6**	5.2	7.4	**-2.1**	-	-	-
JP Morgan Infrastructure Fund	0.9	2.5	**-1.6**	6.1	10.4	**-3.9**	-	-	-
Infrastructure									
Permira Credit Solutions IV Fund	2.0	1.7	**0.3**	9.1	7.0	**2.0**	-	-	-
Churchill Middle Market Senior Loan II Fund	1.5	1.7	**-0.2**	4.4	7.0	**-2.4**	-	-	-
Private Credit									
Wells Fargo RMF Fund	1.6	1.6	**0.0**	25.5	25.5	**0.0**	-	-	-
Risk Management Framework									
LCIV CQS MAC Fund	2.0	1.1	**0.9**	13.4	4.3	**8.7**	4.0	4.7	**-0.7**
Multi Asset Credit									
Cash	-	-	-	-	-	-	-	-	-
Total Fund	4.8	4.3	**0.5**	20.1	14.5	**5.0**	10.4	7.8	**2.4**

Note: 12-month performance for the LCIV Ruffer Absolute Return Fund is since inception on 13 January 2021.

Source: Fund performance provided by Investment Managers and is net of fees.
Benchmark performance provided by Investment Managers and DataStream

Market Background

Amid accumulating evidence of the effectiveness of vaccines, the deployment of large US fiscal stimulus, and greater economic resilience to the latest waves of COVID-19, growth forecasts continued to see upwards revisions. A very sharp rebound in global GDP growth is expected to have been recorded in Q2 as restrictions eased in the major advanced economies. Leading indicators, such as PMI business surveys, have reached multi-year highs and suggest growth momentum remains strong.

Global equities have risen 7.1% (Local Currency) in Q2. Cyclical, shorter-duration sectors, such as financials, industrials and basic materials, and styles, such as value and small-cap, have underperformed, having outperformed significantly since the initial positive vaccine news in November last year. Conversely, technology, with its longer-duration growth characteristics, outperformed during Q2.

From a regional perspective, Japan has materially underperformed as a resurgence in new COVID-19 cases led to new restrictions. Outperformance by the technology sector helped North America to outperform.

Supply and demand imbalances, largely due to pandemic-induced shortages, and a weak base of comparison in 2020 suggest UK headline CPI will increase above May’s 2.1% year-on-year rise. June’s 5.0% year-on-year increase in US headline CPI exceeded expectations. However, most forecasters and central bankers expect the inflationary spike will prove temporary.

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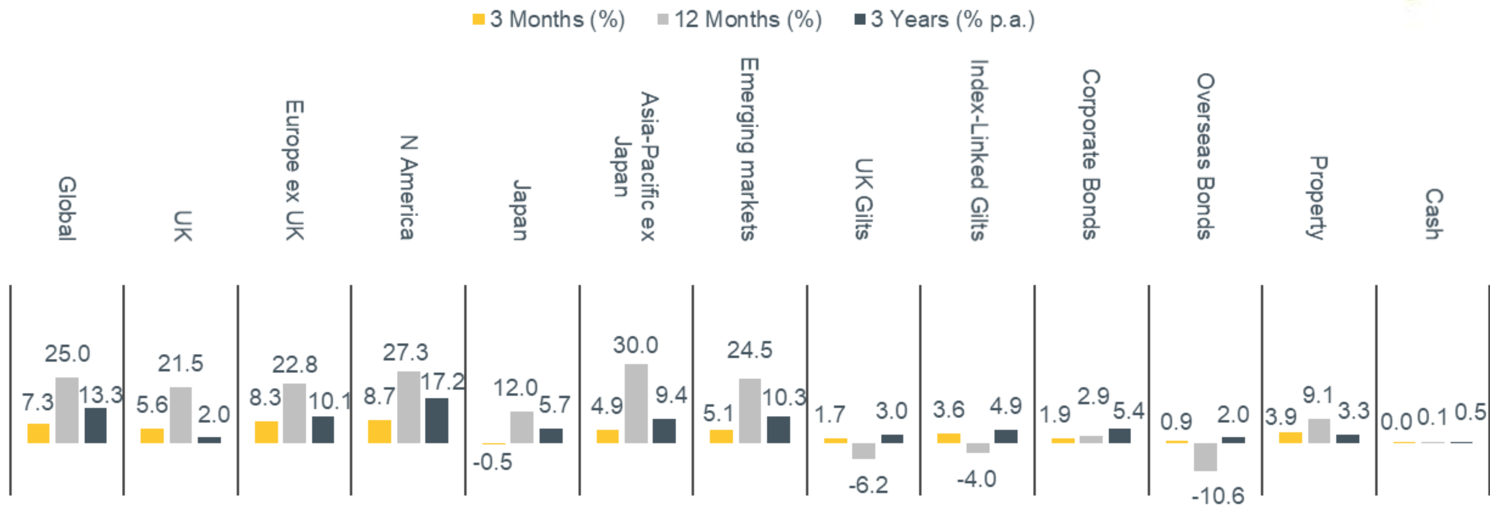
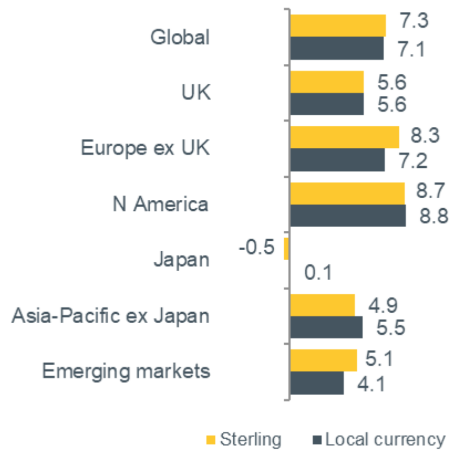
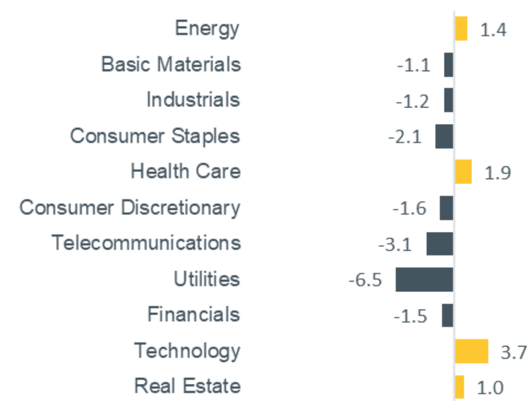
Historic returns for world markets [1]



Regional equity returns [2]



Global equity sector returns (%) [3]



Source: DataStream. [1] Returns shown in Sterling terms. Indices shown (from left to right) are: FTSE All World, FTSE All Share, FTSE AW Developed Europe ex-UK, FTSE North America, FTSE Japan, FTSE AW Developed Asia Pacific ex-Japan, FTSE Emerging, FTSE Fixed Gilts All Stocks, FTSE Index-Linked Gilts All Maturities, iBoxx Corporates All Investment Grade All Maturities, JP Morgan GBI Overseas Bonds, MSCI UK Monthly Property; UK Interbank 7 Day. [2] FTSE All World Indices. Commentary compares regional equity returns in local currency. [3] Returns shown in Sterling terms and relative to FTSE All World. FTSE indices migrated to a new ICB structure in Q1 2021.

On news that the Fed expects to increase its policy rate twice in 2023, short-term yields rose, and longer-term yields fell. Despite upside inflation surprises, US 10-year treasury yields fell 0.3% p.a. to 1.5% p.a. and UK yields fell 0.1% p.a. to 0.7% p.a. The gathering pace of vaccine roll out in the eurozone helped equivalent German yields rise 0.1% p.a.

UK 10-year Implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, fell from 3.7% p.a. to 3.5% p.a. as nominal yields fell relative to real yields.

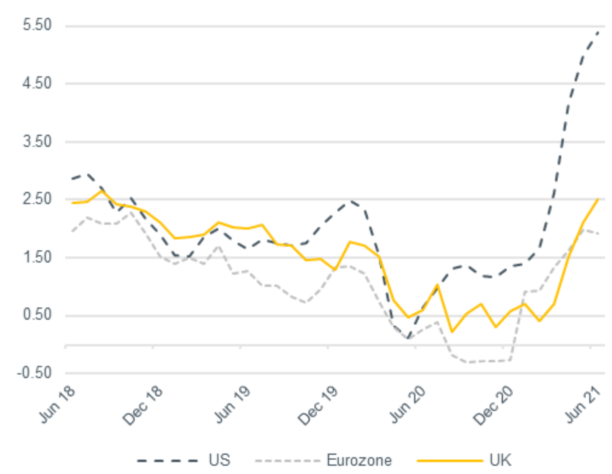
Despite rising 1.4% in June on the back higher near-term rate expectations, the trade-weighted dollar has weakened 1.6% since the end of March, as the global economic recovery became broader based. Sterling has weakened marginally in trade-weighted terms, down 0.5% since the end of March.

Despite slipping 7% in the wake of the Fed meeting in June, gold prices were still up 3.6% over the quarter while oil prices rose strongly.

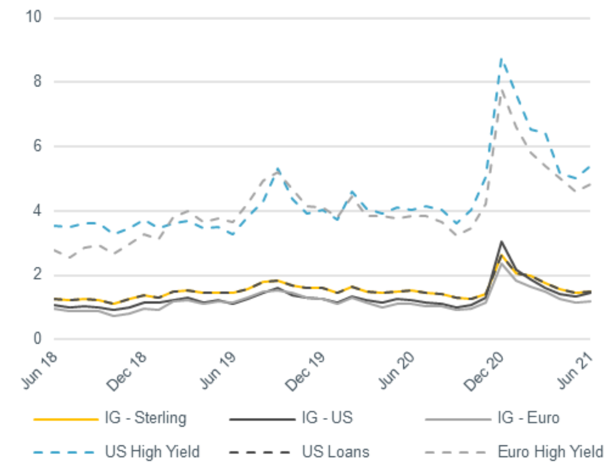
Global credit spreads continued to trend lower in-line with declining default rates and improving credit fundamentals.

Rolling 12-month UK Monthly Property Index metrics have improved as March 2020 values fell out of the comparison. The rolling 12-month total return on the index was 9.1% to end-June, with monthly returns positive since July 2020. Capital values, in aggregate, have risen 3.4% over the last 12 months, with values rising month-on-month since November 2020: Industrial capital values are responsible for the rise, having risen 17.9% over the last 12 months, while retail and office values have fallen, by 5.4% and 3.4%, respectively. The office sector has been experiencing the largest capital declines in recent months.

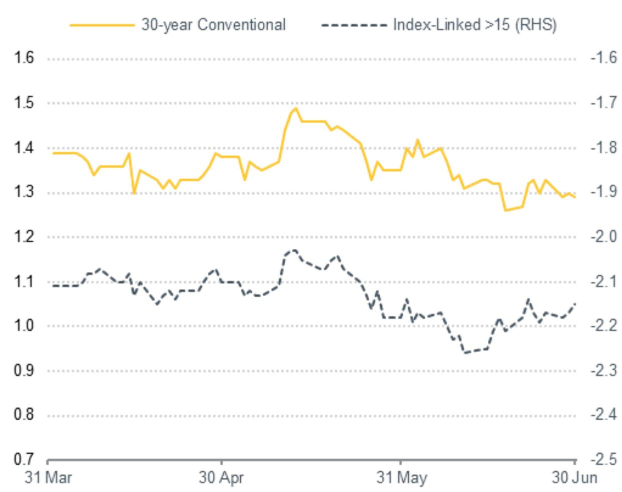
Annual CPI Inflation (% p.a.)



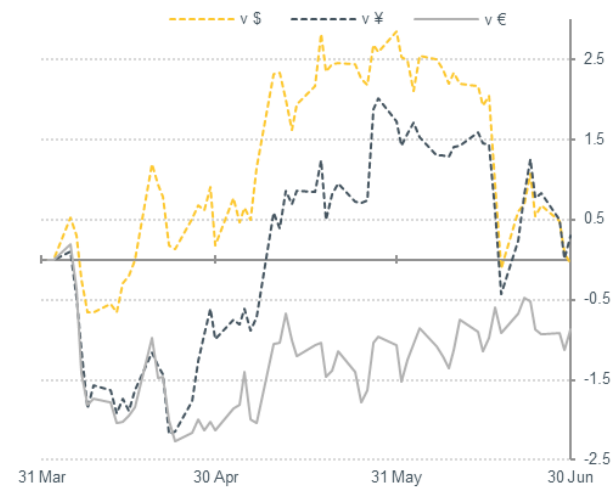
Investment and speculative grade credit spreads (% p.a.)



Gilt yields chart (% p.a.)



Sterling trend chart (% change)



Source: DataStream, Barings and ICE

Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

In some cases, we have commercial business arrangements/agreements with clients within the financial sector where we provide services. These services are entirely separate from any advice that we may provide in recommending products to our advisory clients. Our recommendations are provided as a result of clients' needs and based upon our independent research. Where there is a perceived or potential conflict, alternative recommendations can be made available.

Geometric v Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

$$\frac{(1 + Fund\ Performance)}{(1 + Benchmark\ Performance)} - 1$$

Some industry practitioners use the simpler arithmetic method as follows:

$$Fund\ Performance - Benchmark\ Performance$$

The geometric return is a better measure of investment performance when compared to the arithmetic return, to account for potential volatility of returns.

The difference between the arithmetic mean return and the geometric mean return increases as the volatility increases.

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